

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **201010021**
Release Date: 3/12/2010

Index Number: 1362.04-00

Third Party Communication: None
Date of Communication: Not Applicable
Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:B02
PLR-137684-09
Date:
November 16, 2009

LEGEND

X =

Date =

State =

Year 1 =

Year 2 =

Year 3 =

Year 4 =

Dear :

This responds to a letter dated August 10, 2009, submitted on behalf of X, requesting a ruling regarding X's status as an S corporation.

The information submitted states that X was incorporated in Year 1 in accordance with the laws of State. X elected to be an S corporation effective Date. X represents that it has only had a single class of stock outstanding since Date. X also represents that, as a matter of State law, all of X's outstanding shares have identical rights to distribution and liquidation proceeds.

Since Year 2, X has made distributions to shareholders that were not in proportion to the shareholders' ownership interests in X. There was no pattern of

favoring certain shareholders over others. Additionally, beginning in Year 3, X's distributions to shareholders were further disproportionate due to an incorrect reckoning of the shareholders' ownership percentages.

X represents that it was not aware that any of these disproportionate distributions could potentially jeopardize X's S election until Year 4. Shortly thereafter, X began to make corrective distributions (plus interest) so that each shareholder would receive a pro rata share of all distributions, but for timing differences. Shareholders who received excess distributions are repaying these excess distributions, including interest, to X.

Section 1361(a)(1) of the Internal Revenue Code provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for the year.

Section 1361(b)(1)(D) provides that, for purposes of subchapter S, the term "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not, among other things, have more than one class of stock.

Section 1.1361-1(l)(1) of the Income Tax Regulations provides that a corporation is generally treated as having only one class of stock if all outstanding shares of stock of the corporation confer identical rights to distribution and liquidation proceeds.

Section 1.1361-1(l)(2)(i) provides that the determination of whether all outstanding shares of stock confer identical rights to distribution and liquidation proceeds is made based on the corporate charter, articles of incorporation, bylaws, applicable state law, and binding agreements relating to distribution and liquidation proceeds (collectively, the "governing provisions"). Although a corporation is not treated as having more than one class of stock so long as the governing provisions provide for identical distribution and liquidation rights, any distributions (including actual, constructive, or deemed distributions) that differ in timing or amount are to be given appropriate tax effect in accordance with the facts and circumstances.

Section 1362(d)(2)(A) provides that an election under § 1362(a) will be terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. Section 1362(d)(2)(B) provides that the termination shall be effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in such termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such termination, steps were taken so that the corporation is a small business corporation, and (4) the corporation, and each person who was a shareholder in the corporation at

any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

Based solely on the information submitted and the representations made, we conclude that it is not clear on these facts whether there was a termination of X's S election. However, we conclude that, if X's S election was terminated, such termination was inadvertent within the meaning of § 1362(f). Therefore, we rule that X will be treated as continuing to be an S corporation from Year 2, and thereafter, provided that X's S election is not otherwise terminated under § 1362(d).

This ruling is contingent upon X making the corrective distributions within 90 days of the date of this letter. X's shareholders, in determining their respective income tax liabilities during the termination period and thereafter, must include their pro rata share of the separately stated computed items of income or loss of X as provided in § 1366, make any adjustments to basis provided in § 1367, and take into account any distributions made by X as provided in § 1368.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed or implied as to whether X otherwise qualifies as an S corporation under § 1361.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Bradford R. Poston
Senior Counsel, Branch 2
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

cc: